

Profligate Spenders...



One of the distressing economic conditions over the past year has been much lower levels of consumer spending. Businesses that had catered to, and profited from, the record high spending of the recent past now face a difficult period of restructuring from ultra-free spending to a more frugal consumer.

Consumption, which accounted for about 64.3 percent of economic activity in the U.S. during the 80s, reached a summit of 70.5 percent in 2008. The personal savings rate (total savings in the U.S. as a percent of total disposable

personal income), which averaged about 9.8 percent from 1970 to 1985, dropped from about 7.7 percent in 1992 to zero, going negative briefly, as U.S. households spent more than they earned at the peak of the housing bubble in 2005 and 2006. During this period, households made home equity withdrawals totaling almost a trillion dollars from what was, in most cases, wildly inflated home prices.

The easy credit and skyrocketing asset values that characterized the housing and stock market bubbles created large paper gains and the presumption that

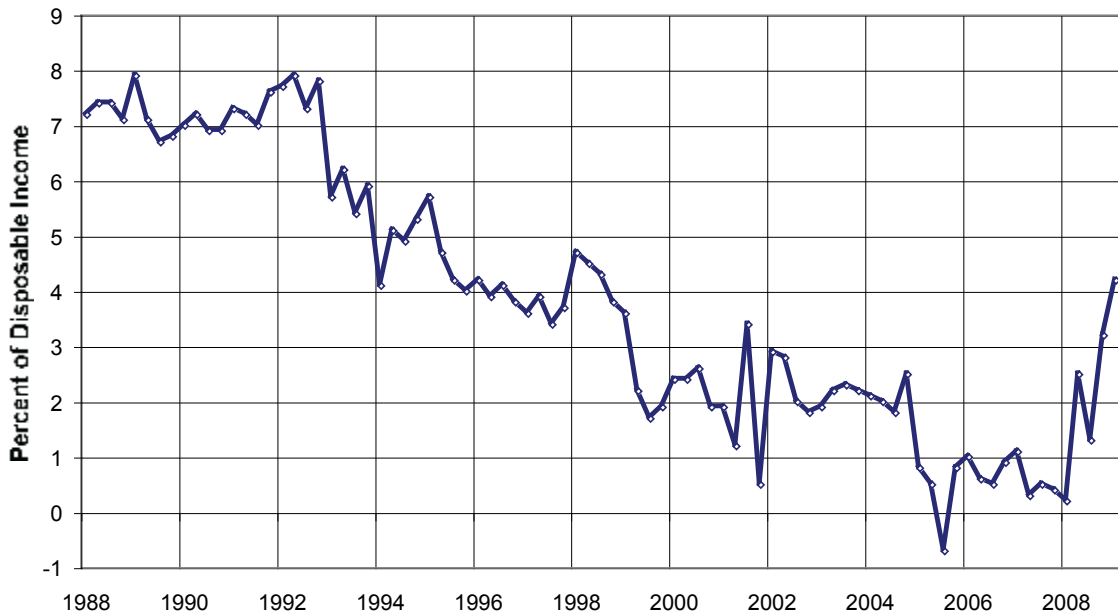
their perceived wealth would only grow in the future. This gave households the confidence to spend freely, often using debt that seemed reasonable at the time to finance their expenditures. The flip side was that many financial institutions, under relaxed or non-existent regulations, were eagerly promoting and providing the credit.

Businesses became dependent on the very high levels of consumer spending. The severe recession—with high unemployment, reduced earnings, and lower household equity wealth—is forcing consumers to abandon their free-spending ways. Businesses, as they plan for the future, must try to adjust to the long-term impacts of the current recession and the on-going structural changes to the economy.

Recent polls of U.S. households have tried to gauge whether the recently reduced levels of consumer spending and higher levels of household savings are just the results of the current higher rates of unemployment, the fear of job loss, and housing difficulties, or whether a new attitude of increased frugality and more saving will persist after the economy recovers. A Pew Research Center survey found that quite a number of Americans now believe some products previously viewed as a necessity, like a microwave, are now viewed to be more of a luxury. A Gallop poll from last April indicated that many American households believe that the adjustments they have made to increase savings are a “new, normal pattern for years ahead.”

What people say they will do is one thing, their actual future behavior is what counts. There are a number of reasons why this higher savings rate may last beyond the current recession. The high asset values of the housing boom will not return, some credit tightening is permanent, and new regulation will be put into place to prevent some of

U.S. *Personal Savings* Rate by Quarter: 1st Quarter 1988 to 1st Quarter 2009



Source: U.S. Bureau of Economic Analysis

...to Prudent Savers?

the freewheeling financial excesses that developed during the boom. It is also expected that baby boomers are feeling the need to save more for retirement and to help fund the expensive cost of their children's college educations.

As the summer begins, the national economic news is still dominated with reports of job losses, contracting business demand, and lower consumer and business spending. The most positive news is that economic conditions are deteriorating at slower rates and that the bottom of this recession may be in sight. If a new frugal consumer becomes the norm, the increased savings should lead to more investment, greater productivity, and higher living standards in the long run. ●

